

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 97-0583 and 98-0355**

**Sales/Use Tax — Miscellaneous Items
For Tax Periods: 1991 through 1996**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax — Utilities

Authority: IC 6-2.5-6-1

Taxpayer protests proposed Audit assessments on certain utility purchases.

II. Sales/Use Tax — In-Store Equipment

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2; IC 6-2.5-5-3(b)
45 IAC 2.2-5-10(k)

Taxpayer protests proposed Audit assessments of use tax on taxpayer's purchases of equipment used in its grocery stores.

III. Sales/Use Tax — Labels and Packaging Materials

Authority: IC 6-2.5-5-9
45 IAC 2.2-5-15

Taxpayer protests proposed Audit assessments on labels and packaging materials.

IV. Sales/Use Tax — Other Equipment

Authority: 45 IAC 2.2-5-8(d) and (e)

Taxpayer protests proposed Audit assessments of use tax on taxpayer's purchase of a pan washing machine and a raw milk silo (including accessories).

STATEMENT OF FACTS

Taxpayer is a major retail grocery store chain with over 1,100 (at the time of audit) retail stores. Taxpayer also operates over 25 manufacturing and food processing facilities throughout the United States. The manufacturing and processing operations represent separate divisions. Taxpayer's retail stores are grouped into marketing divisions; each division operates approximately 120 retail stores.

The sales/use tax audits (2) cover tax years 1991 through 1996. Included in the taxpayer's audit group are three (3) retail store divisions, two (2) dairies, one (1) bakery, one (1) distribution center, and one (1) specialty foods division.

Audit's review of taxpayer's transactions resulted in proposed assessments of Indiana sales and use tax. Taxpayer now protests these assessments.

I. Sales/Use Tax — Utilities

DISCUSSION

Taxpayer protests Audit's assessment of use tax on "exempt" utility purchases. Taxpayer explains:

A tax adjustment of \$4,640.16 was taken [by Audit] on [taxpayer's] 1992 return for sales tax paid on [the] non predominate use percentage of electricity used directly in processing at retail stores during 1991. The issue was not whether the amount was due to the taxpayer or a question of the exempt nature of the use. The item was assessed tax because of the procedure followed by [taxpayer] in getting the tax credit. The taxpayer was advised by its consultant...to take the credit on [Line K of] its [sales tax] return. [The consultant] claims the state had given [the consultant] authorization to do this.

Taxpayer has forwarded to the Department a copy of a letter (on Department letterhead; date omitted, subject line omitted, and inside address omitted) purportedly addressed to taxpayer. The relevant part of this brief letter instructs:

If there are any billing invoices that were not included with this claim [a previously filed Claim for Refund], you may take credit for them on Line K of your Indiana Sales and Use Tax Return.

Taxpayer did, in fact, take credit on Line K for "sales tax paid on [the] non predominate use percentage of electricity used directly in processing at retail stores during 1991." In denying these credits, Audit explained:

Department procedures regarding proper filing of the Indiana Sales and Use Tax Return (Form ST-103) dictate that the adjustment line on the return may be used

for adjustments to the current year only. Departmental procedure requires that for amounts overpaid in prior years a claim for refund (Form GA-110L) [must] be filed with the Department prior to Statute expiration. Since the taxpayer failed to properly and timely file a claim for refund, these items are now out of statute for refund [; consequently,] the adjustment improperly claimed on the return filed is denied.

As an initial matter, absent proper attribution—i.e., dates, parties (to whom the correspondence is directed), and subject matter—the Department will not address the substance of the purported “permission letter.”

In 1992, taxpayer, on Line K of its Indiana Sales and Use Tax Return (Form ST-103), entered as an adjustment a \$4,640.16 credit for sales tax erroneously paid on 1991 utility purchases. Line K on the current Indiana Sales and Use Tax Return (Form ST-103A, revised 7-93) is entitled “ADJUSTMENTS.” The instructions associated with Line K state: “This line is to be used whenever an underpayment or overpayment of sales tax has been made. In case of an overpayment, the credit on this line cannot be greater than the amount due for the period. Carry any overpayment to line K of your next return or file a claim for refund on Form GA-110L.”

Indiana Registered Retail Merchants are required to file Indiana Sales and Use Tax Returns with the Indiana Department of Revenue. As IC 6-2.5-6-1 instructs:

Each person liable for collecting the state gross retail or use tax shall file a return [e.g., ST-103 or ST-103A] for each calendar month and pay the state gross retail and use taxes that the person collect during that month.

Indiana Sales and Use Tax Returns are filed by those permitted to *collect* Indiana sales tax (a trust tax) on behalf of the State of Indiana. With few exceptions, the amounts remitted have been paid by the remitter’s (in this case, taxpayer’s) customers. Adjustments associated with sales tax remitted (i.e., Line K “Adjustments”) will necessarily be limited to modifications associated with the *collection of sales tax paid by others*. Such returns are not intended to record adjustments of *sales tax paid by the remitter*. Consequently, taxpayer should not have used its Indiana Sales and Use Tax Return to recoup sales tax erroneously paid on prior year utility purchases.

FINDING

Taxpayer's protest is denied.

II. Sales/Use Tax — In-Store Equipment

DISCUSSION

Taxpayer, primarily a retail merchant engaged in selling groceries, argues that the following equipment should qualify for the “processing” sales and use tax exemptions. Taxpayer opines:

The issue of contention is the assessment of tax on various equipment used in the store's deli, cheese, meat and produce departments to process food items.

* * * * *

These items [listed below] qualify for the processing exemption as defined in Indiana Department of Revenue sales and use tax regulations 45 IAC 2.2-5-10(c)(2)(d) and 45 IAC 2.2-5-10(k). In addition, these items are exempt pursuant to the court decision in Indianapolis Fruit Co. vs. Department of State Revenue.

In Indiana, an excise tax (sales tax) is imposed on retail transactions. IC 6-2.5-2-1. A complementary excise tax (use tax) is imposed on tangible personal property that is stored, used, or consumed in this state. IC 6-2.5-3-2. Several exemptions are available. IC 6-2.5-5-1 *et seq.* Taxpayer, in this instance, invokes one of the industrial exemptions.

Referred to as the equipment exemption, IC 6-2.5-5-3(b) reads:

Transactions involving manufacturing machinery, tools and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for *direct* use in the *direct* production, manufacture, fabrication, assembly, extraction, processing, refining, or finishing of other tangible personal property. (Emphasis added.)

Specifically, taxpayer cites 45 IAC 2.2-5-10 which exempts "machinery, tools, and equipment [that is] directly used by the purchaser in processing...." Taxpayer argues that such processing occurs in the meat, cheese, deli, floral, produce, and bakery departments of its grocery stores.

"Without production there can be no exemption." Indianapolis Fruit Co. vs. Department of State Revenue, 691 N.E.2d 1379, 1384 (Ind. Tax Ct. 1998). That is, absent a finding that taxpayer is producing (or processing) tangible personal property at its in-store meat, cheese, deli, floral, produce, and bakery departments, the equipment used will not qualify for any of the industrial exemptions. With regard to processing, the Department looks to regulation 45 IAC 2.2-5-10(k) for guidance. The regulation states in relevant part:

Processing or refining is defined as the performance by a business of an integrated series of operations which places tangible personal property in a form, composition, or character different from that in which it was acquired. ***The change in form, composition, or character must be a substantial change*** (emphasis added).

Consistent with the aforementioned descriptions, the Department finds that taxpayer performs a modicum of processing activities within its in-store bakery and meat departments. Conversely, work performed within taxpayer's cheese, deli, and produce departments cannot be characterized as the processing of tangible personal property. Rather, such activities represent ancillary services associated with those, like taxpayer, who are engaged in the retail sale of groceries.

Therefore, the autolabeler scales purchased for exclusive use in the meat department will qualify for exempt treatment. However, the labeling scales and parts used in the cheese, deli, and produce departments will not be exempt. Given the Department's finding that processing does not occur within taxpayer's produce department, the pineapple peeler and produce mist system also fail to qualify for exempt treatment.

Taxpayer also maintains a floral department within its grocery stores. Taxpayer, in arguing for exempt treatment for its floral workstations explains: "[the] [f]loral workstations are used...to process flowers and other materials into various floral arrangements and gift items that are sold in the stores." Pursuant to 45 IAC 2.2-5-10(k), the Department finds that taxpayer's floral activity does not represent an exempt process. The assembly of flowers into various arrangements does not substantially change the form, composition, or character of the items being assembled. Consequently, taxpayer's floral workstations enjoy no exemption.

And finally, taxpayer has purchased coffee grinders used by taxpayer's customers to create blends of coffee—coffee subsequently sold by taxpayer. Taxpayer contends the coffee grinders qualify for a processing exemption because the "[c]offee grinders are used to grind coffee beans into a marketable form of ground coffee." Even assuming the validity of taxpayer's use argument, the coffee grinders do not qualify for an exemption because the coffee grinders are not used by the purchaser (i.e., taxpayer) in an exempt manner. Rather, it is taxpayer's customers who use the coffee grinders.

FINDING

Taxpayer's protest is partially sustained and partially denied pursuant to the aforementioned language.

III. Sales/Use Tax — Labels and Packaging Materials

DISCUSSION

Taxpayer contends Audit's assessments of use tax of certain labels and packaging/wrapping material were in error. Taxpayer advances the following rationale:

Packaging material used in [taxpayer's] manufacturing facility (bakery) and in-store processing departments is exempt under IC 6-2.5-5-9. Product description and pricing labels are placed on the manufactured items by the bakery as part of the entire packaging process. In addition, product description and pricing labels are placed on in-store manufactured items as part of the packaging process. In addition, product description and pricing labels are placed on in-store manufactured items as part of the packaging process. These items are packaging materials as defined in 45 IAC 2.2-5-16. In addition, these labels are incorporated into the product and qualify for the resale exemption as defined in 45 IAC 2.2-5-15.

Wrapping (packaging) materials are exempt from sales tax “if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.” IC 6-2.5-5-9. The packaging and wrapping materials used in taxpayer’s in-store departments—i.e., meat, cheese, deli, produce, floral, and bakery—to package products for subsequent resale qualify for this exemption. Similar types of packaging and wrapping materials used at taxpayer’s off-site (non-retail) bakery facility also qualify for this exemption. But note, packaging and wrapping materials used to facilitate the shipment of product from taxpayer’s off-site bakery to taxpayer’s retail stores enjoy no such exemption.

Similarly, the description and pricing labels incorporated into the taxpayer’s products at the taxpayer’s off-site facility – and intended for use by the ultimate consumer – are entitled to the exemption afforded under IC 6-2.5-5-6 because the labels are “incorporat[ed] as a material part” of the products produced at the off-site facility.

However, the description and pricing labels applied at the taxpayer’s retail facilities – even if intended for use by the ultimate consumer – are not entitled to the exemption. A necessary predicate to the taxpayer’s enjoyment of the exemption is that the taxpayer be engaged in “assembl[ing], refin[ing], or process[ing]” at the time the labels are incorporated into the product. Accordingly, when the taxpayer – operating out of one its retail facilities – is merely acting as the purveyor of finished goods when labels are affixed to those goods, the taxpayer is not entitled to the exemption.

FINDING

Taxpayer's protest is partially sustained and partially denied pursuant to the aforementioned language.

IV. Sales/Use Tax — Other Equipment

DISCUSSION

Audit proposed assessments of use tax on taxpayer’s purchase of a pan washing machine and a raw milk silo (accessories included).

The pan washing machine is used in taxpayer’s bakery operations. As taxpayer explains:

The bakery [taxpayer’s] produces various types of products such as bread, rolls, donuts and cakes. As part of the integrated production process, each cake pan is thoroughly cleaned. The taxpayer contends that the cleaning process is exempt pursuant to 45 IAC 2.2-5-8 as an essential and integral part of the integrated production process. If the pans were not thoroughly cleaned and sanitized, the finished product would be tainted and not marketable.

Assuming *arguendo* that taxpayer's baking pans are used in an activity that represents an essential and integral part of an integrated production process, the *cleaning* of such pans is not such an activity. Cleaning production equipment is generally, as it is in this instance, a post-production activity. Equipment purchased for use in post-production activities are not exempt. 45 IAC 2.2-5-8(d).

The raw milk silo is used by taxpayer in its dairy operations. (Taxpayer's dairy produces various dairy products such as fluid milk, ice cream, cottage cheese, and yogurt.) According to taxpayer:

The raw milk silo is exempt pursuant to 45 IAC 2.2-5-8. The raw milk silo maintains the proper temperature of the material and is designed to continuously agitate the raw milk so the cream does not separate. This is the beginning stage of production. The consistency of the raw milk is essential to the homogenization stage of the integrated dairy process.

The raw milk silo is used to store the raw milk (i.e., a raw material) prior to its introduction into taxpayer's integrated production process. During storage, the raw milk silo operates to maintain the desired qualities of the raw milk. That storage is performed in a manner to ensure the integrity of a raw material does not serve to transform a pre-production storage activity into one of production. 45 IAC 2.2-5-8(e). Since the raw milk silo and accessories are used in pre-production activities, these items do not qualify for any of the industrial exemptions.

FINDING

Taxpayer's protest is denied.